# Don't Turn Bearish Yet

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One of the main reasons we didn't turn bearish at the end of 2022 was the underlying strength of the consumer. While the nature of consumer spending has changed from goods to services, Americans are spending money like never before, with personal consumption expenditures up 24% since the peak of 2020 and 53% since the worst part of the COVID-era. In the latest episode of "Bullish," we highlighted deteriorating retail earnings which some economists have pointed to as canary in the coal mine. This could be an issue for the economy in the future, but we don't think signals a broader problem right now. Rather, recent data show consumers spending more on cruises, airfare and restaurants as opposed to grills, treadmills, and cars.

Structural economic forces that went into effect in 2019 are returning as the economic engine this year. First, the United States is a services heavy economy. For example, while Apple makes goods such as iPhones, iPads and Watches, a growing portion of the company's revenue is derived from Apple TV+ that now has over 1 billion paid subscribers. Services make up 25% of Apple's revenue and 41% of gross profit. Large S&P 500 Index companies have pivoted toward re-occurring subscription-based revenue as opposed to less predictable product revenue.

Another powerful economic force that's continued in 2023 is consumer deleveraging. While student loan payments could slow down younger consumers, the Baby Boomer generation is flush with cash. In some ways, higher interest rates are a form of stimulus for millionaires. Household debt service as a percent of disposable personal income is lower than before COVID lockdowns began, and household debt to GDP is nearly 10% lower than peak Q4 2020 levels. Simply put, consumers are in tremendously better shape today than they were leading up to 2008 and 2009.

A third structural economic trend boosting consumers is a record tight labor market. Companies are shelling out more than ever to find top notch talent. Unlike many other previous time periods, people of all educational backgrounds are earning record levels of nominal income. Workers with no college education are doing well too. Recent CNBC reports show UPS drivers now making $172,000 per year including benefits. Our country also faces a critical shortage of skilled tradespeople. Starting wages for electricians, plumbers, construction workers, HVAC technicians, carpenters, pipefitters, and welders now exceed $60,000 per year. In our opinion, a future bright spot for student loan debt will be more high school graduates choosing the trades over many low return college degrees.

Consumer spending makes up 70% of the economy which is why many people track sentiment. One of the problems with consumer sentiment surveys though is herd mentality. People may feel bad when they answer the survey but, behave differently in reality. In many environments, the University of Michigan's consumer sentiment index operates as a contra-indicator for investors. Consumer sentiment peaked in 1999 during the tech bubble, one of the worst times to buy stocks. It bottomed out in 08/09, one of the best times to buy stocks. Today, the index is 31% lower than peak 2020 levels which provides another reason for equity owners to remain bullish. While we could see a short-term correction, many pundits are overly bearish and cash heavy, putting us far away from a market bubble in our view.

Consumer spending is rarely the canary in the coal mine doom and gloomers are hoping for. Despite small decreases along the way, spending not only keeps up with inflation but outpaces it by 1-2% per year. There clearly is a government induced divide between the haves and the have nots, but our country is wealthier now than it's ever been. One final structural force we see as a long-term economic positive is the Great Wealth Transfer where Baby Boomers are set to pass $84 trillion to their children through 2045, $12 trillion of which will be donated to charity. This should continue to drive consumer spending and markets higher for years to come.

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